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Honorable John H. Crooker, Jr.
Chairman
Civil Aeronautics Board
Washington, D. C. 20428

Dear Mr. Chairman:

Aviation negotiations with Italy have now been recessed. Of the principal issues between ~~the two countries~~, we are reasonably confident that a satisfactory arrangement can be concluded on routes, all-cargo services, the text of the agreement and capacity. If this evaluation is correct, we have made major advances from the position a year ago, when we were far apart on all of these issues, except possibly the text. However, with respect to the important issue of multiple designation, the positions of the two sides remain far apart.

The Italians stated in the last round that it is impossible for Italy to accept a situation in which they would be faced with an indefinite number of United States carriers operating to Italy. They have pointed out that this issue is one on which the two countries have long been at odds. The Italian position has always been that the appropriate regime for US/Italian aviation relations is one in which each country is represented by one designated carrier. They realize that, however much they would want such a regime and however fair they believe it to be--and they want it very much and believe it to be the fairest kind of deal--this is not a position the United States could accept. As a result, they have said that in an effort to obtain an accommodation with the United States, they are prepared to concede the continuance of the existing number of US carriers now operating to Italy, leaving it to the United States Government to determine which carriers should be designated.

The US Delegation, with the advice of the CAB, has so far maintained the position that the United States should be prepared to limit the number of carriers operating from any single point in the United States to three, but that it should be open to the United States Government to

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determine which carriers should operate on each of these routes. The US Delegation has further stated that the US Government would be prepared to consult with the Italian Government on an ex post facto basis if the US Government should designate any new carrier, i.e., one not now operating to Italy, on any route.

The Italian Delegation has indicated that the US proposal would involve the theoretical possibility of establishing a number of US carriers to Italy equal to three times the number of routes actually operated.

We have, of course, stated that in the real world this could not happen. And there is no doubt that the Italians understand this. On the other hand, the fact is that the certification of a number of additional carriers by the United States seems to the Italians to be a very real possibility, and we believe that this view is not unreasonable.

It is important to note how the Italians--and indeed most of our aviation partners--look at this question. They have committed themselves to operating with one scheduled carrier. They have no very practical alternative, and find our suggestion that they consider designating additional carriers to be quite disingenuous. The United States, on the other hand, has three carriers operating to Italy now--two of them considerably larger than the Italian carrier.

The Italians have several concerns with the possibility of a new carrier. The first is based on considerations other than any specific economic or commercial effects of this numerical imbalance; they feel that an agreement which permits us to start with three US carriers and add carriers at our convenience is unfair in principle and in concept, because it lacks the reciprocity that they value so highly. This feeling seems to be particularly prevalent in the upper echelons of the Italian Government where the problem is, not unexpectedly, viewed in somewhat simplistic terms. More important are the Italian apprehensions of commercial unfairness. They believe that a new carrier would be influenced in its capacity and scheduling decisions more by the need to "establishing identity in the market" and by the level of operations of its US competitors than by strict considerations of the immediate requirements of the

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market being served. The net result would be substantial additional capacity and, the Italians fear, substantial competitive damage to the Italian carrier. While not articulated by the Italian Delegation, the Italian carrier is reported to have indicated that the prospect of new carriers in the Atlanta/Dallas market would completely invalidate their economic calculations on the route balance.

In the view of the Italians, this issue is intimately related with the US insistence that operations to Italy be under the Bermuda capacity principles. As you know, the Italians don't agree with these principles and don't operate under them with others. They have relatively little faith in the ability of ex post facto consultations to undo harm. However, they are prepared to live with the Bermuda approach in their relations with the United States because we have made it clear that it is an absolute bedrock of our position. If they could obtain effective controls over capacity, we believe they might accept the US position on multiple designation. In the absence of such controls, however, it is quite clear to us that a relatively open-ended multiple-designation provision cannot be achieved with the Italians.

The above discussion does not really raise critical new aviation policy issues; it simply brings out into the open issues which have existed over the past years. We have considered this question with great care and have come to the following conclusions:

1. It is vitally important for the United States to continue its historic efforts to put bilateral aviation relations--with Italy and others--under bilateral agreements. In that way we get--and we cannot get in other ways--an assurance of future operations that permits US carriers to make sound plans for the future and to operate under Bermuda capacity principles.

2. We cannot hope to conclude meaningful bilaterals in which the views of the two sides on a basic issue such as multiple designation grow increasingly apart. A bilateral simply is not an effective instrument if it covers over fundamental differences of this sort.

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3. If the United States wishes to maintain the right to certificate and designate additional carriers to serve international markets--as we assume the United States will wish to do--then the United States must be prepared to negotiate and pay for designations additional to those in the end acceptable to the other governments. We are well aware that this formulation may at first appear to be a radical departure from the present regime. It is not. First, it does not tie the hands of the Board in considering whether, by US standards, additional carriers are desirable to serve specific markets. It simply means that that determination would not always be implemented without negotiations with the other Government. This is not fundamentally different from the current situation where the Board determines that the public interest requires authorization of a US carrier to serve a route not covered by a particular bilateral agreement. Second, this approach in reality only makes explicit what is now implicit in our bilateral relations. Generally, our right to designate more than one carrier stems from the use of the words "airline or airlines" in our bilateral agreements. No one suggests that an indefinite number of carriers can be designated under this language, and certainly in practice I believe both the Board and the Department are in agreement that our ability to effect additional designations in more countries and maintain our Bermuda capacity principles is extremely limited.

We believe that if the United States were to lose an agreement it wants and values in an effort to obtain broad or unlimited theoretical rights of multiple designation, it would be a very bad bargain, for it would lose an agreement in the quest of a right that, in practical terms, cannot be implemented.

In the Italian case, we do not recommend accepting the Italian position. We do recommend an adjustment in the US position which takes into account the practical situation in the real world. We believe it desirable that we retain the right to place a new carrier in the Atlanta/Dallas market, and that this right not be subject to Italian veto, although we would accept an a priori consultation provision similar to the arrangement we have with Japan or the

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United Kingdom. With this exception we would propose to accept the concept that we would not place additional carriers in the United States-Italy market, i.e., other than those now operating to Italy in the New York, Boston, Chicago, and Los Angeles markets, without negotiating this out with Italy.

We believe the above course should go a long way to meeting the Italian difficulties and should represent an overall acceptable deal for Italy.

Should the Board desire to discuss this matter further, I would be prepared to meet with the Board at your convenience.

Sincerely yours,

Frank E. Loy
Deputy Assistant Secretary
Bureau of Economic Affairs

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cleared: A/S: Mr. Stabler

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